United States Court of Appeals

for the Second Circuit

REPLY BRIEF

76-7125

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

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Docket No. 76-7125

GERALD LIPSKY, executor under the Will of WALDEN ROBERT CASSOTTO (a/k/a/ BOBBY DARIN) deceased,

Plaintiff-Appellant,

P/S

- against -

COMMONWEALTH UNITED CORPORATION (now known as IOTA INDUSTRIES, INC.), COMMONWEALTH UNITED MUSIC, INC., THE HUDSON BAY MUSIC COMPANY (formerly known as ALLEY-STREET MUSIC VENTURE), ALLEY MUSIC CORPORATION, and STREET SONGS, INC.,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF FOR PLAINTIFF-APPELLANT

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases: Page

Cases: Page

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REPLY STATEMENT

This brief is submitted in reply to the brief of the defendants Commonwealth United Corporation, now known as Iota Industries, Inc. ("CUC"), and its wholly-owned subsidiary Commonwealth United Music, Inc. ("CUM"), and the brief of the

defendants The Hudson Bay Music Company, Alley Music Corporation and Street Songs, Inc. (the "Hudson Bay defendants"). The facts are as stated at pages 4 through 13 of the plaintiff's brief. The reply is necessitated by the defendants' failure to address themselves or to apply their purported authorities to the issues properly before the Court on this appeal.

ARGUMENT

I. The Second Amended Unified Complaint States a Valid Claim for Rescission under New York Law for Breach of an Undertaking that was an Essential Element of the Contract

Defendants have taken the position that rescission is not an available remedy unless there was a failure of an essential element of the contract and that no such case may be presented under the Second Amended Unified Complaint Filed Pursuant to Pretrial Conference Order Dated July 11, 1975 (the "Second Amended Unified Complaint"). In view of the allegations of the Second Amended Unified Complaint as to the materiality of CUC's best efforts obligation, the plaintiff's reliance upon that obligation and the breach of that obligation resulting in total failure of consideration (App. 169, 164, 165, ¶¶ 21, 6, 9)*, each of which must be deemed admitted on this appeal, and the authorities cited by the plaintiff (Br. 15-23), their position is untenable.

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* ¶ refers to paragraph of the Second Amended Unified Complaint, set forth at pages 161-171 of the Joint Appendix (App. ____).

Defendants cite nothing in their briefs which could lead the Court to a contrary conclusion. Callanan v. Keeseville, Ausable Chasm and Lake Champlain Ry. Co., 199 N.Y. 268, 92 N.E. 747 (1910) stands for the proposition advanced by the plaintiff that the remedy of rescission is available for a material breach of contract; in Nolan v. Williamson Music, Inc. 300 F. Supp. 1311 (S.D.N.Y. 1969), aff'd, 499 F.2d 1394 (2d Cir. 1974) rescission was denied because the breaches were minor and plaintiff could be made whole by an award of money damages; O'Herron v. Southern Tier Stores, Inc., 9 App. Div. 2d 568, 189 N.Y.S.2d 323 (3d Dep't 1959) stands for the same proposition as Callanan and rescission was not awarded because the court found that the earlier accomplishment of the promised event would not have advantaged plaintiff in any way; and in Smith v. Johannsen, 199 App. Div. 823, 192 N.Y.S. 478 (1st Dep't 1922) and Tarleton Building Corp. v. Spider Staging Sales Co., 26 App. Div. 2d 809, 274 N.Y.S.2d 43 (1st Dep't 1966) the courts found that the plaintiffs had a complete and adequate remedy at law for damages. Holdeen v. Rinaldo, 28 App. Div. 2d 947, 281 N.Y.S.2d 657 (3d Dep't 1967) is the only case of any relevance cited by defendants, and it held that rescission was available and ordered restitution. It was error for the court below not to have done likewise.

II. The Complaint States a Claim for Rescission and Restitution against the Hudson Bay Defendants

Defendants suggest that even if rescission were an

available remedy against CUC and CUM, the Second Amended Unified Complaint does not demonstrate the availability of such relief against the Hudson Bay defendants. Their position is contrary to reason and their authorities in no way warrant departure in this case from equity's mandate not to suffer a wrong without a remedy. J. N. Pomeroy, II Equity Jurisprudence §§ 423, 424 (5th Ed. 1941).

The rule in this Circuit with respect to equitable relief and intervening interests was set forth clearly in First National Bank of Cincinnati v. Pepper, 454 F.2d 626, 635 (2d Cir. 1972):

> "[I]t is for the court 'in equity to procure the declaration of a rescission on whatever terms may be just.' Marr v. Tumulty, 256 N.Y. 15, 22, 175 N.E. 356, 358 (1931) (per Cardozo, C.J.)."

The defendants have shown no obstacle to plaintiff's claim other than to allege generally that the intervening interests of others make restitution impossible. Moreover their cases add nothing to their arguments because they deal with allegedly fraudulent transfers which the courts held not to be fraudulent, E. W. Bliss Co. v. Progressive S. & M. Corp., 208 App. Div. 346, 203 N.Y.S. 320 (1st Dep't 1924); Parker v. Conner, 93 N.Y. 118 (1883), or are distinguishable on their facts and because the plaintiffs could be made whole by an award of damages, Valentine v. Richardt, 126 N.Y. 272, 27 N.E. 255 (1891) and Rudman v. Cowles Communications, Inc., 30

N.Y.2d 1, 280 N.E.2d 867 (1972) (damages adequate); Hall v. Bank of Blasdell, 306 N.Y. 336, 118 N.E.2d 464 (1954) (fraudulent transfer of negotiable instrument to holder without notice); Vidor v. Serlin, 7 N.Y.2d 502, 166 N.E.2d 680 (1960) (concerned the priority of recording an assignment in the Copyright Office and the court found that plaintiff did not have notice of defendants "claims"); Overseas Credit Corp. v. Cal-Tech Systems, Inc., 20 App. Div. 2d 355, 247 N.Y.S.2d 252 (1st Dep't), aff'd, 14 N.Y.2d 909, 200 N.E.2d 859 (1964) (receipt of notes at sizable discount does not constitute notice of infirmity and holder not found to have had knowledge of litigation challenging validity of notes); Gordon v. Burr, 506 F.2d 1080 (2d Cir. 1974) (dicta, and the Court did not consider the case of a third party transferee with notice); and Kuhlman v. Pacific States Savings & Loan Co., 17 Cal.2d 820, 112 P.2d 620 (Cal. 1941) (in an action to compel payment of judgment for damages, assets had been transferred to defendant before plaintiff commenced suit against transferor). Hopian v. Knauth, 156 Misc. 545, 282 N.Y.S. 219 (Mun. Ct. 1935) involved a review of a jury charge regarding constructive notice in a case to set aside the wrongful seizure and conversion of personal property.

Finally, plaintiff has properly cited Marr v. Tumulty, 256 N.Y. 15, 23, 175 N.E. 356 (1931) for the rule that "Rescission is not checked until the property to be reclaimed has passed into the ownership of a purchaser for value without

notice of the wrong." In this case, as in Marr, the third parties were not innocent purchasers for value but took with notice of this action and extracted indemnities against plaintiff's claims including those asserted herein. (App. 168, 169). Defendants' cases do not derogate from this rule.

> ". . . a person who acquires a legal title or an equitable title or interest in a given subject matter, even for a valuable consideration, but with notice that the subject matter is already affected by an equity or equitable claim in favor of another, takes it subject to that equity or equitable claim." J. N. Pomeroy, II Equity Jurisprudence § 591 (5th ed. 1941) (citations omitted and emphasis supplied).

III. Equitable Rescission Will Restore the Parties to the Contract as Nearly as Possible to Their Former Positions

The function of equitable rescission is to restore the parties to the contract as nearly as is possible to their positions status quo ante.

Plaintiff seeks restoration of the TM assets, including copyrights in unique musical compositions by Darin. If such nonfungible assets of TM are encumbered by liabilities, the defendants should come forward and plead and prove such, but their bald assertions to this effect cannot be seriously entertained on a Rule 12(b)(6) motion.

In First National Bank of Cincinnati v. Pepper, supra, this Court made emphatically clear that equity will not be frustrated even in difficult cases:

> "Although technically rescission here as it is accomplished in a normal case is impossible [because the parties seeking to rescind did not restore the consideration allegedly transferred], it has long been recognized in New York that 'The terms upon which rescission may be granted where complete restoration of the parties to their former positions is impossible rests in the sound discretion of the courts,' Buffalo Builders' Supply Co. v. Reeb, 247 N.Y. 170, 176, 159 N.E. 899, 901 (1928) (per Lehman, J.)." 454 F.2d at 626.

Nothing cited by the defendants can lead this Court to conclude that the District Court should be relieved of its responsibility to attempt to fashion relief herein.

In Ungewitter v. Toch, 31 App. Div. 2d 583, 294 N.Y.S.2d 1013 (3rd Dep't 1968), aff'd, 26 N.Y.2d 687, 308 N.Y.S.2d 858 (1970) the court denied rescission because an award of money damages was adequate ("it is well established that damages may be granted in lieu of equitable relief"); in Slater v. Slater, 208 App. Div. 567, 204 N.Y. 112 (1st Dep't 1924), aff'd, 240 N.Y. 557, 148 N.E. 703 (1925) plaintiff failed to offer to restore the benefits received under the agreement; in Pullman v. Alley, 53 N.Y. 637 (1873) the court found that the plaintiff had sold most of the stock purchased, thus could not tender restoration, had otherwise affirmed the transaction, and should seek its remedy in damages for fraud; in Schiffer v. Dietz, 83 N.Y. 300, 312 (1881), an action to rescind a conveyance of real property based on fraud, the court held that the defendant's "tender of title . . . was in equity an answer to the claim for rescission"; in

Curtiss v. Howell, 39 N.Y. 211 (1868) the plaintiff did not offer to restore the consideration he had received; and in Bedell v. Bedell, 3 Hun. 580 (2d Dep't 1875) plaintiff failed to sustain a claim of fraudulent inducement.

IV. Plaintiff's Claim is Not Barred by Laches

Defendants CUC and CUM argue plaintiff is barred by plaintiff's decedent's delay in seeking rescission. This argument, essentially a prediction of an unpleaded affirmative defense to be proved, if at all, at trial, is not properly before this Court. (App. 198-200). Furthermore, the issue of laches was expressly deferred to another day by the District Court. (App. 159). In any event, the lack of substantive merit in defendants' argument can be summarily shown.

If perceived correctly, defendants' position is that notwithstanding CUC's failure to take steps to fulfill a material and essential element of the contract (i.e. to use its best efforts to effect registration of Darin's shares of CUC stock at the earliest practicable time), plaintiff's claim must fail because Darin did not act more promptly in giving notice of his claim for rescission (April, 1970) or commencing this action (August, 1970). The position is untenable on the record and as a matter of law.

The law of New York is clear that in a rescission suit notice may be given at any time within the statutory

limitations period (which in this case ran at least six years after the filing of the November 1968 registration statement, New York Civil Practice Law and Rules § 213) in the absence of showing of special circumstances requiring earlier notice to avoid inequity. Converse v. Schmidlapp, 264 App. Div. 381, 35 N.Y.S.2d 486 (1st Dep't 1940), aff'd, 290 N.Y. 834, 50 N.E.2d 237 (1943).

The Court of Appeals in Richard v. Credit Suisse, 242 N.Y. 346, 152 N.E. 110 (1926), following Barnette v. Wells Fargo Bank, 270 U.S. 438, 445 (1925) stated the rule in New York:

> "What promptness of action a court may reasonably exact . . . must depend in large measure upon the effect of lapse of time without such disaffirmance, upon those whose rights are sought to be divested." (emphasis supplied).

Neither CUC nor CUM indicates how their rights were, or could have been, affected by whatever time elapsed before Darin's notice. Indeed, their claim is totally without factual support. As to the Hudson Bay defendants, there can be no defense of laches because they took with full notice of Darin's claims and all the infirmities of CUC's position. "Laches in legal significance, is not mere delay, but delay that works disadvantage to another." J. N. Pomeroy, II Equity Jurisprudence § 419d (5th ed. 1941)

The authorities cited in no way relieve defendants of their burden of demonstrating how they were prejudiced by any purported delay. Goldman v. Sontag, 257 App. Div. 688, 15 N.Y.S.2d 407 (3rd Dep't 1939) was an action at law based on a claim of fraud which was not established; Sarantides v. Williams, Belmont & Co., 180 N.Y.S. 741 (Sup. Ct. App. Term, 1st Dep't 1920) involved a claim for rescission asserted after the claimant's apparent ratification of the contract with full knowledge of the misrepresentation; Daitz Flying Corp. v. United States, 167 F.2d 369 (2d Cir. 1948) was an action for damages based on the defendant's rescission of a contract; Trowbridge v. Oehmsen, 207 App. Div. 740, 202 N.Y.S. 833 (2d Dep't 1924), aff'd, 241 N.Y. 564, 150 N.E. 556 (1925) was an action based on fraud commenced without prior offer of restoration, the complaint contained only "a very unusual and limited offer to restore" and the court found it "difficult to understand how plaintiff could have been deceived or misled"; Calhoun v. Millard, 121 N.Y. 69, 24 N.E. 27 (1890) was an action for cancellation of securities delayed nine years and the securities were in the possession of purchasers without notice; Strong v. Strong, 102 N.Y. 69, 5 N.E. 799 (1886) involved a prior motion by plaintiff to vacate a decree of the Surrogate passing the defendant's accounts upon the ground of fraud and the court found, inter alia, that plaintiff's petition lacked any offer to return

the property received or some valid excuse for not doing so; Hallanan v. Webber, 7 App. Div. 122, 40 N.Y.S. 103 (1st Dep't 1896) was a case where plaintiff, fully aware of the fraud and intended transfer, waited until after the assignor transferred the property to an assignee before seeking to rescind; Martin-Barris Co. v. Jackson, 24 App. Div. 354, 48 N.Y.S. 586 (4th Dep't 1897) concerned a plaintiff who, after discovery of the fraud, delayed nearly three years and on three occasions wrote to the defendant and affirmed the contract; and United States Plywood Corp. v. Hudson Lumber Co., 113 F. Supp. 529 (S.D.N.Y. 1953) was a case where the defendant, after discovering the alleged grounds for rescission, continued for more than four years to accept deliveries under the contract and made its counterclaim for equitable relief only after the plaintiff commenced an action for money due on said contract.

V. Rescission is Not Barred By Failure to Plead Damages

Defendants CUC and CUM argue that the Second Amended Unified Complaint is deficient and rescission unavailable because plaintiff has not pleaded injury or, more specifically, has not pleaded the causal connection between the breach (which is not "alleged" but admitted for purposes of this appeal) and the injury.

For this proposition defendants do not, and indeed cannot, cite a single apposite authority. Defendants' one

case, Stern v. Andrew, 249 App. Div. 171 (1st Dep't 1936) is simply not on point - it was an action at law for damages based on fraud.

The law is as stated in Lauer v. Raymond, 190 App. Div. 319, 180 N.Y.S. 31 (1st Dep't 1920). The recipient of a promise has an "absolute right" to insist on performance by the promisor:

> "The condition being thereafter broken, the plaintiffs were free to rescind the contract . . ." 190 App. Div. at 329.

Plaintiff has pleaded a promise, materiality, reliance, change of position, and breach. Every essential element of a claim for equitable rescission has been pleaded. See, Scheidl v. Universal Aviation Equipment, 159 N.Y.S.2d 278 (Sup.Ct. 1957), Nigro v. Caserta, 16 Misc.2d 355, 357 184 N.Y.S. 2d 1001, 1004 (Sup.Ct. 1959).

The relevance of Hoshman v. Esso Standard Oil Co., 263 F.2d 499 (5th Cir. 1959) and Brooks v. United States, 152 F. Supp. 535 (S.D.N.Y. 1957) cannot be fathomed. Hoshman, a tort action by decedent's wife against the former's employer, was dismissed because the complaint did not show that the workmen's compensation law should not govern, and Brooks was dismissed as not properly brought under the Federal Tort Claims Act. No such jurisdictional infirmities are present in this record.

VI. Rescission is Not Barred for Failure to Allege an Independent Breach by CUM

Defendants' passing suggestion that the Second Amended Unified Complaint must fail because it contains no allegation of an independent breach by CUM warrants scant reply. Plaintiff rests on the arguments set forth in his principal brief and notes that the two authorities cited by defendants are inapposite. Royal Industries v. St. Regis Paper Co., 420 F.2d 449 (9th Cir. 1969) involved the question of whether one colicensor could, without the latter's consent, terminate a written license, and Rudman v. Cowles, supra, denied rescission because, inter alia, damages appeared adequate, and there was no indication that the court was concerned with the plaintiff's failure to allege an independent breach by Cowles' subsidiary.

VII. The Second Amended Unified Complaint States a Valid Claim for Restoration of the TM Assets

Plaintiff seeks a restoration of the assets owned by TM at the time of closing of the contract. Those assets were referred to in paragraphs 11 and 12 of Darin's initial complaint (App. 7, 8) and in the contract which was attached as an exhibit thereto. (App. 31-36). Each succeeding complaint did likewise. (App. 75, 81, 165, 170, 171). In his original complaint Darin gave notice that his demand for rescission contemplated restoration of the TM assets at

paragraph 37,* where he alleged that rescission would not adequately compensate him, because the defendants CUC, CUM and others had allowed such assets to decline in value, and demanded money damages in addition to rescission. (App. 15, 16). Finally, the transparency of the Hudson Bay defendants' argument is apparent in light of the fact that they received an indemnification from CUC, CUM and others against loss as a result of Darin's claims, including an award of the TM assets. (App. 168, 169).

The cases cited by the Hudson Bay defendants (Br. 13) are completely off the mark - plaintiff is not attempting to sue in behalf of TM for misappropriation of assets or to ignore the corporate existence of TM or any of the defendants. Plaintiff's arguments raised in its brief stand unopposed by any authority cited by defendants.

VIII. The District Court's Order Striking Portions of the Amended Unified Complaint was Prejudicial and Constituted Reversible Error

The impact of the District Court's order striking certain portions of plaintiff's prior pleading is apparent by comparing the affected paragraphs (10, 11, 13 and 14). (App. 76, 77, 78 and 166, 167). Allegations of deficiencies in filings by CUC have been converted, in some instances, into neutral statements of fact. CUC and CUM argue that

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* "Rescission of the contract attached hereto as Exhibit 'A' . . . will not adequately compensate plaintiff since defendants, and each of them, have allowed the assets of T.M. to decline in value as a result of their failure to exploit such assets . . . . Therefore, plaintiff has been damaged in the further sum of $1,000,000.00 which plaintiff demands in addition to the restoration of all consideration transferred by plaintiff . . . ."

such emasculation of the Second Amended Unified Complaint was called for under Rule 12(f) of the Federal Rules of Civil Procedure but their arguments stand without precedent or authority.

The defendants marshal some antitrust and other consent decree cases which offer no support to their pending motions. Section 5(a) of the Clayton Act (15 U.S.C.A. § 16(a)) provides that:

> "A final judgment or decree heretofore or hereafter rendered in any civil or criminal proceeding brought by or on behalf of the United States under the antitrust laws to the effect that a defendant has violated said laws shall be prima facie evidence against such defendant in any action or proceeding brought by any other party against such defendant under said laws or by the United States under section 15a of this title, as to all matters respecting which said judgment or decree would be an estoppel as between the parties thereto: Provided, That this section shall not apply to consent judgments or decrees entered before any testimony has been taken. . . ."

This case is not an antitrust action; plaintiff does not plead the SEC action as proof of the accuracy of the Commission's allegations therein; indeed, the consent decree has not been pleaded.

Moreover, in one of the cases relied on by defendants, Atlantic City Electric Company v. General Electric Company, 207 F. Supp. 620 (S.D.N.Y. 1962) while the court, pursuant to section 5(a) of the Clayton Act, ordered references to

please of nolo and judgments entered on pleas of nolo stricken from the complaints, it held that:

> "a complaint shall be regarded as containing instead of such stricken references statements of when the criminal action was begun and terminated, if no such averments appear in the complaint." 207 F. Supp. 630.

Finally, although plaintiff may not have been prejudiced on this appeal by the District Court's order, because the breach of the best efforts covenant is admitted, it is important that the record below be corrected so that on remand a fair trial can proceed.

CONCLUSION

Because the defendants' arguments are unsupported in law or in fact, the District Court's order and judgment should be reversed and the action remanded with instructions to reinstate the Amended Unified Complaint.

Dated: New York, New York
July 16, 1976

Respectfully submitted,

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